Legacy

Annual Report 1987

Legacy Petroleum Ltd.

CORPORATE PROFILE

Date Incorporated
October 14, 1970

Incorporated In
Province of Alberta

Date Continued
February 11, 1983

Predecessor Companies
Francis Creek Mines Ltd. (NPL)
October 14, 1970 - June 14, 1971

Frances Creek Mines Ltd. (NPL)
June 14, 1971 - September 9, 1975

Cal-West Petroleums Ltd. (NPL)
September 9, 1975 - May 24, 1985

Head Office
Suite 530 First Alberta Place
777 - 8 Avenue S.W.
Calgary, Alberta, Canada
T2P 3R5
(403) 264-4254

Wholly-owned Subsidiaries
Legacy Oil & Gas Ltd.
Legacy Oil & Gas Inc.
Benchlands Oil & Gas Inc.
Harkor Developments Ltd.

Directors
Murray F. Craig
William Y. Kennedy
Carol A. Mossfeldt
A. Kenneth Mossfeldt

Officers
A. Kenneth Mossfeldt
President

Murray F. Craig
Vice-President, Operations

Transfer Agent and Registrar
The Canada Trust Company
505 - 3 Street S.W.
Calgary, Alberta T2P 3Y8

Auditor
M. Jane McKinnon,
C.A., B. Comm
Calgary, Alberta

Canadian Solicitors
Lenhardt Pawluk
Calgary, Alberta

U. S. Solicitors
James R. Learned
Attorney at Law
Cheyenne, Wyoming

Robert Balsam
Attorney at Law
Billings, Montana

Main Banking Connection
Treasury Branches of Alberta
Calgary, Alberta

Other Banking Connections
Northwest Trust Company
Calgary, Alberta

First State Bank of Shelby
Shelby, Montana

Stock Exchange Affiliation
Alberta Stock Exchange
Calgary, Alberta

Year End
May 31

Trading Symbol
LCY-A

Share Type
Capitalization/Issued and Outstanding
Class "A" Voting Common Share unlimited
3,422,978

Class "B" Non-Voting Common Shares unlimited
nil

Preferred Shares
500,000; 25 series #1 $10,000 per share
(redeemed 8 May 1, 1987)

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PRESIDENT'S MESSAGE

The past fiscal year has been both a trying and exciting one for your Company. We have done a number of things, the results of which are not in all cases reflected in the current financial results, but we feel confident that they will bring substantial future rewards.

In presenting our audited consolidated financial statements for the year ended May 31, 1987, we would like to make our Shareholders aware of several important facts. While the Company recorded a consolidated net loss of $515,606, or 20 cents per share, it is the opinion of the Board of Directors that this does not reflect the operating results of the past fiscal year, or the future strength of your Company to survive during these difficult times.

As so often happens in reporting financial statements, you get a combination of "non-monetary" and "monetary" items. Sometimes the non-monetary results have a far stronger effect on the overall picture, and this is the situation with the current financial statements. The Extraordinary Loss on the sale of the Granite Creek mining prospect, which had never produced any revenue for your Company or its predecessor's, resulted from the consolidation of Legacy Petroleum Ltd., and its wholly-owned subsidiary Harkor Developments Ltd. Through a series of events, Legacy had written down the costs of the mining prospect, however, Harkor had not. On consolidation the original value, paid in the form of shares, resulted in a "non-monetary" loss of $471,607.

On a positive note, the Company increased its revenue from operations by 43% from $156,586 in 1986 to $278,800 during the current fiscal year. The loss before extraordinary item of $40,533 is down nearly 50% from that reported for the prior year. Your Board of Directors finds this significant, inasmuch as your Company drilled six wells and re-entered five during the fiscal year, compared to no drilling exposure other than in an override position to payout, the preceding year at Steelman, Saskatchewan. Legacy's exposure to the 1986-1987 drilling program averaged 65% working interest. Taking into account additional non-monetary items of depletion and depreciation and loss on surrender of oil and gas properties would move the Company's actual results to a profit of $29,540 for the year.

Unfortunately, due to the diminishing price of natural gas through the fiscal year, and the necessity to operate on a fixed gas nomination, the Company has not been able to realize in its current revenue, the results of its expenditures during the period under review. However, your Board of Directors feels that it must build today for the future, and keeping this in mind has additional drilling prospects scheduled for the new fiscal year.

A number of other factors could have had a greater positive impact on the revenue of the Company in the year ended May 31, 1987, however, did not come together in time. The acquisition of a 47.6%, and subsequent to year end the Company entered into negotiations to acquire an additional 9% working interest in a $2 million plus gas plant and producing wells at Castor, Alberta has enhanced the Company's asset base substantially. While the plant did not go on stream prior to year ended, it is expected to be started up prior to the end of 1987. In addition to the natural gas revenue from the Castor facility, the Company could realize a significant amount of funds from its current litigation against certain parties related to the bankruptcy of Pangaea Petroleum Ltd. The results of this litigation are anticipated prior to the fiscal year ended May 31, 1988.

Your Board is actively pursuing a number of areas to increase the Company's cash flow, while keeping its general and operating expenses at a minimum. It is expected that announcements of these developments will be made in the near future.

A. Kenneth Mossfeldt
President, on behalf of the
Board of Directors

October 15, 1987

PRICE RANGE AND TRADING VOLUME

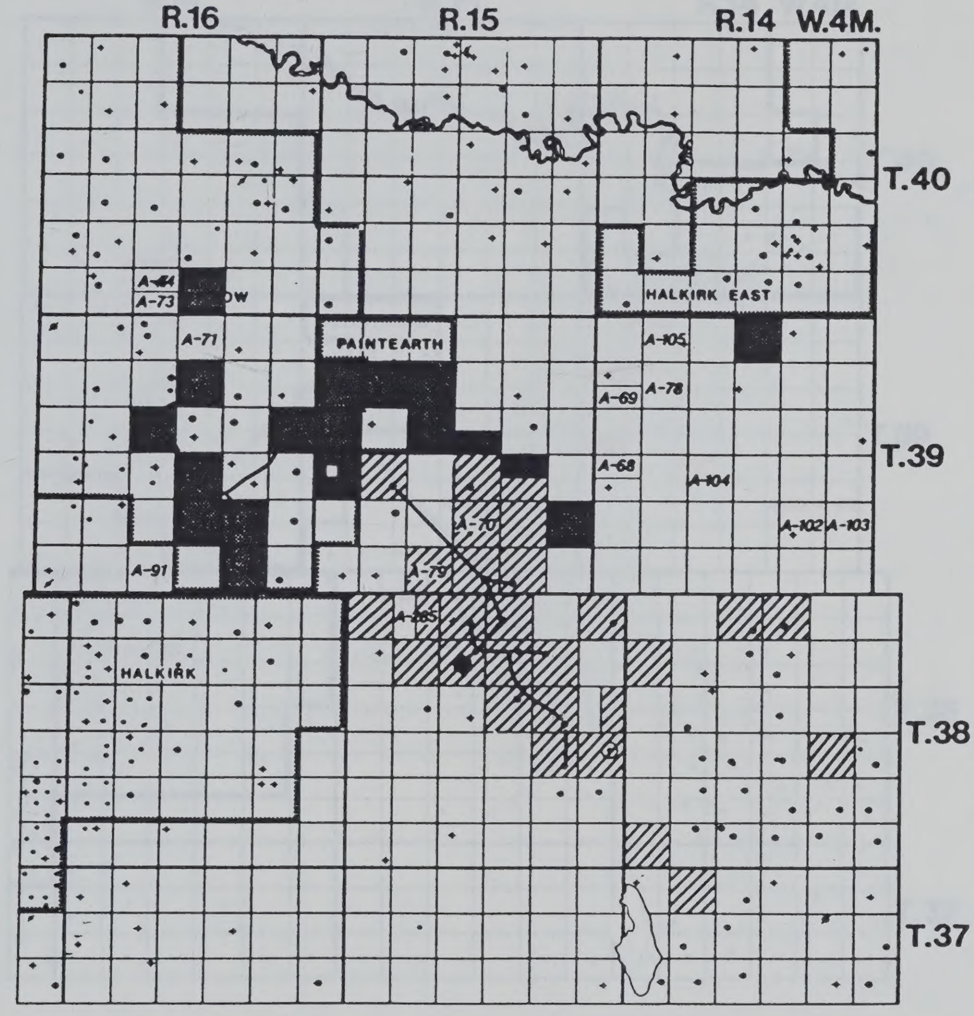
Alberta Stock Exchange Designation
Legacy Petroleum Ltd. – LCY–A

1986	Monthly High (in cents)	Monthly Low (in cents)	Monthly Volume
May	15	12	18,480
Jun	16	15	24,390
Jul	50	15	55,600
Aug	85	30	162,811
Sep	80	50	43,500
Oct	65	32	120,472
Nov	40	35	35,180
Dec	40	40	22,920

1987	Monthly High (in cents)	Monthly Low (in cents)	Monthly Volume
Jan	44	30	26,000
Feb	35	30	25,600
Mar	45	35	66,300
Apr	35	20	81,100
May	34	24	34,900
Jun	26	21	91,200
Jul	26	20	50,270
Aug	28	20	88,793

Petroleum & Natural Gas Leases Sold June 10, 1987 to September 9, 1987

Parcel #	Description	Purchased By	Price/Hectare
A – 68	All 18–39–14w4	Poco Petroleums Ltd.	$92.20
A – 69	All 30–39–14w4	Poco Petroleums Ltd.	92.20
A – 70	All 10–39–15w4	Poco Petroleums Ltd.	272.20
A – 71	N1/2 34–39–16w4	Pioneer Land Services Ltd.	511.60
A – 73	S1/2 & NW1/4 4–40–16w4	Keles Production Co. Ltd.	277.64
A – 74	NE1/4 4–40–16w4	Pioneer Land Services Ltd.	126.56
A – 78	All 29–39–14w4	Encor Energy Corporation Inc.	76.28
A – 79	All 4–39–15w4	Poco Petroleums Ltd.	160.00
A – 91	All 4–39–16w4	Husky Oil Operations Ltd.	621.03
		Vanguard Petroleums Ltd.	
A – 102	NW1/4 11–39–14w4	Voyager Energy Inc.	277.61
A – 103	All 12–39–14w4	Reid–Bicknell Land Ltd.	514.73
A – 104	All 16–39–14w4	Encor Energy Corporation Inc.	157.26
A – 105	All 32–39–14w4	Encor Energy Corporation Inc.	117.60
A – 285	E1/2 32–38–15w4	Poco Petroleums Ltd.	178.88



LEGEND

- WELLS ON PRODUCTION
- RE-ENTRY WELLS
- LEGACY INTEREST LEASES (HALKIRK)
- LEGACY INTEREST LEASES (CASTOR)
- LEGACY OPERATED GAS PLANTS
- GAS GATHERING FACILITIES

A-91 DENOTES P&NG LEASES SOLD
JUNE 10, 1987 - SEPTEMBER 9, 1987

LEGACY PETROLEUM LTD.

RED WILLOW AREA

ALBERTA

0 1 2 3 4 ML

PRICE RANGE AND TRADING VOLUME

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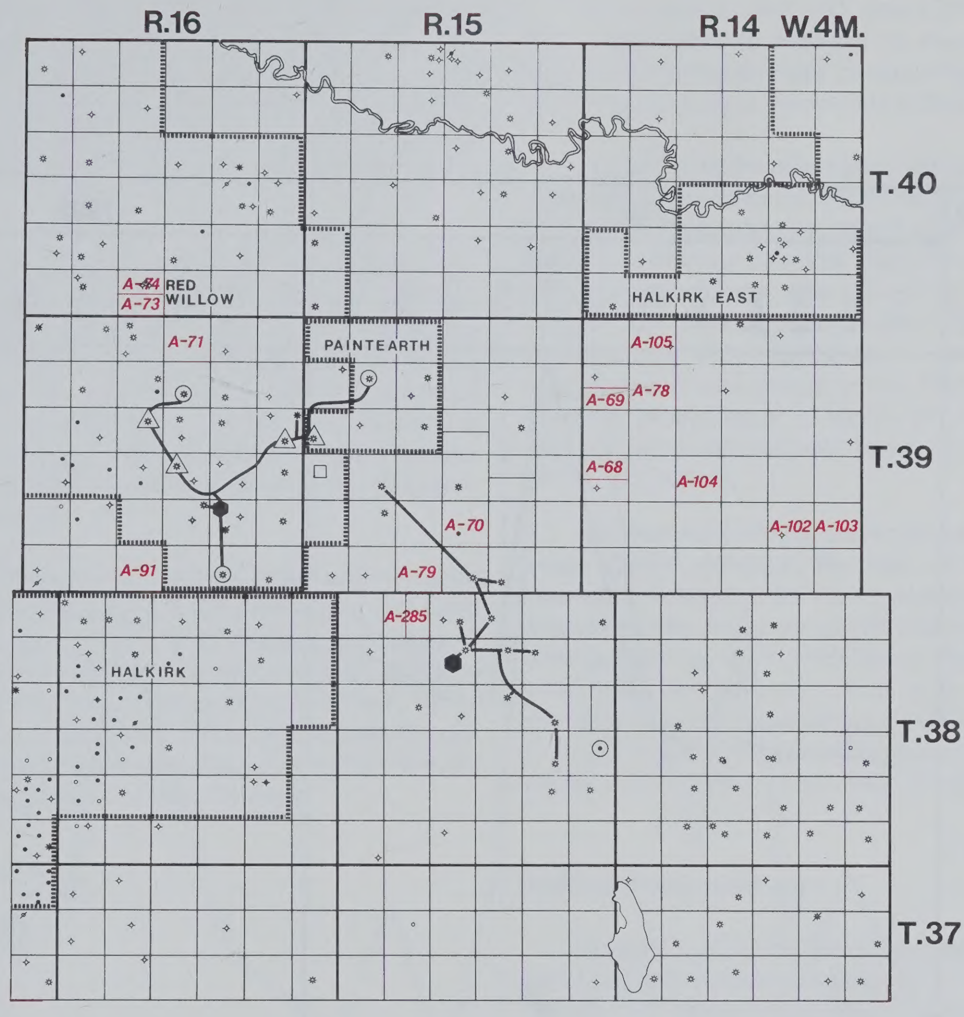


LEGEND

WELLS ON PRODUCTION

RE-ENTRY WELLS

LEGACY INTEREST LEASES (HALKIRK)

LEGACY INTEREST LEASES (CASTOR)

LEGACY OPERATED GAS PLANTS

GAS GATHERING FACILITIES

A-91 DENOTES P&NG LEASES SOLD
JUNE 10, 1987 – SEPTEMBER 9, 1987

LEGACY PETROLEUM LTD.

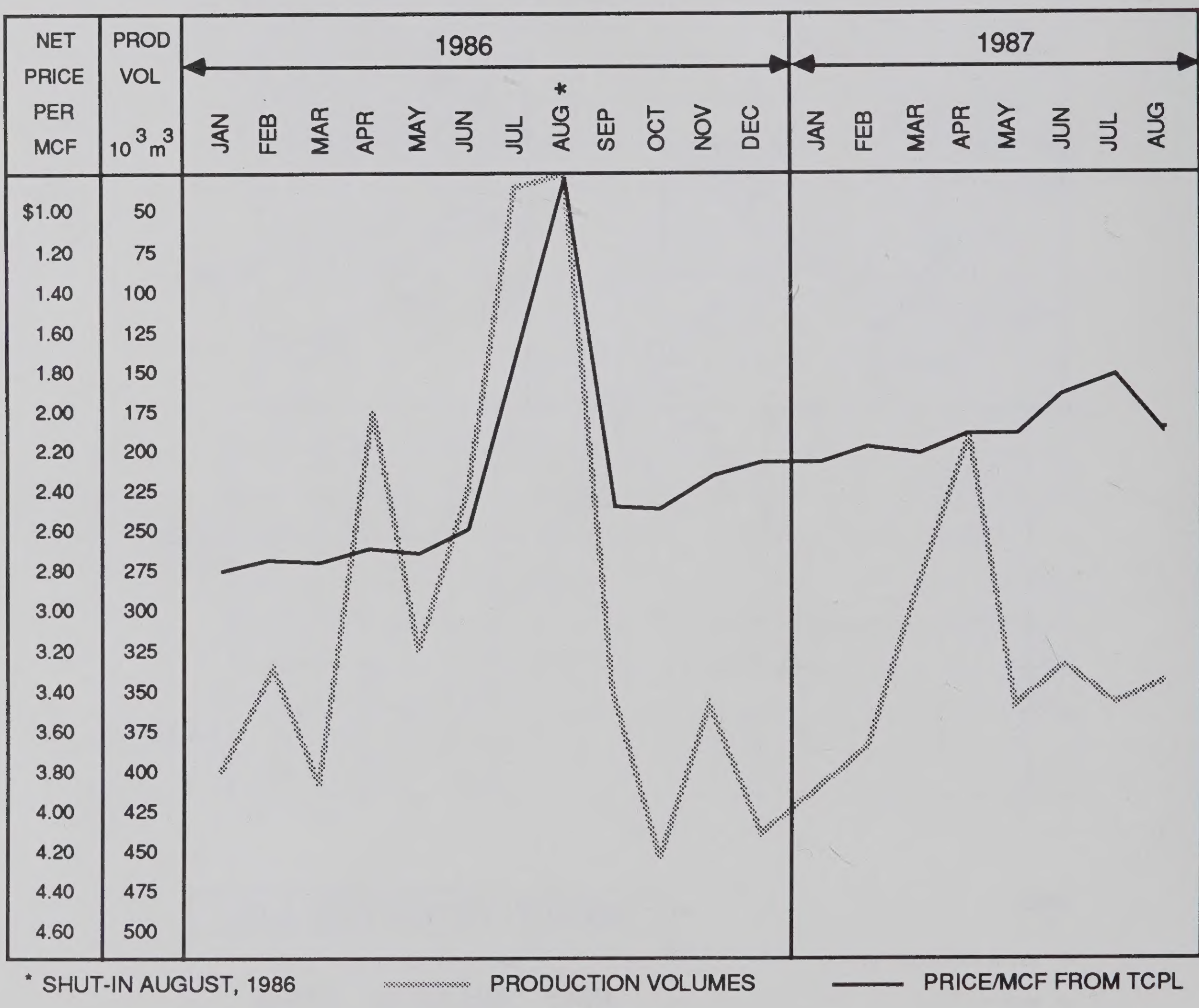
RED WILLOW AREA

ALBERTA

0 1 2 3 4 MI.

(UPDATED AS OF SEPTEMBER 30, 1987)

VOLUMES AND PRICES



FUTURE POTENTIAL HIGHLIGHTS

The future potential of your Company is centered primarily on its petroleum and natural gas lease inventory, and the potential for processing natural gas in the Halkirk–Castor area of central Alberta. Prices paid for rights in close proximity to your Company's acreage support Management's belief in the future potential of this area.

To this end, your Company will endeavor to drill or farmout to further develop its oil and gas reserves, with a view to increasing its utility base. A number of farmout agreements are being negotiated as of the date of this report, the details of which will be announced in the forthcoming months. As well the Company is negotiating the exchange of certain acreage with other independents in the area, to again enhance its potential for cash flow.

While the optimism of mid 1986 has diminished somewhat, and the volatility of both supply and price for natural gas is unsettling to any long term plans, it is the feeling of your Management that the viability of your Company lies in increasing cash flow, while keeping its debt load low. While the increase in cash flow may appear to be very slow, it does demonstrate that the Company is moving forward.

CANADA

ALBERTA

Castor Area

In early 1987 your Company announced the acquisition of a second gas plant, located in the Castor area, some eight miles southeast of Halkirk, together with the acquisition of some twenty–nine sections of petroleum and natural gas leases. The 47.6% interest in this prospect was acquired for a total consideration of $135,000.00, paid for by 225,000 Class "A" common trading shares from Treasury. The plant and lands are highlighted on the map on page 4 of this report, and gives your Company a substantial volume of gas with the infrastructures in place.

The Castor Plant and producing facilities have an estimated market value of $2,078,000.

Subsequent to year end, your Company entered into negotiations to increase its ownership in the Castor processing facilities by acquiring an additional 9% bringing its total ownership to 56.6%.

In addition to the potential for gas production, the lease spread at Castor included one oilwell. This well is currently on production, and the Company should see its first revenue from this production in late October 1987. The Castor area oilwell, in which Legacy has a 47.6% working interest was placed on production from the Viking formation in January of 1977, and produced until shut-in in late 1986. This well is currently producing at 15 barrels of oil per day, and has estimated reserves based on eighty acre spacing of 21, 505 barrels.

Unfortunately, due to the receivership of the previous Castor operator, the sale of the previous operator's interest in the leases, and the problems of monies due by the previous bankrupt operator under a top gas contract with TransCanada Pipelines, the gas wells have not produced since your Company acquired its interest. However, progress towards this end is being made, and from all current indications the Castor plant will be started up before year end.

Halkirk–Red Willow Area

As evidenced by the Table on page 7, your Company was very active in evaluating its land spread in the Halkirk region of central Alberta. During the period of June 1986 to September 1987, your Company participated in the drilling of six prospects, all but one of which was eligible for government grants. Of the six wells drilled, one is on production; two additional tests indicated commercial quantities of natural gas on drillstem tests, but are awaiting a pipeline; two were plugged and abandoned; and the sixth well encountered oil on test, and was placed on production in the fall of last year. Due to problems in the completion of this well, the water to oil ratio made oil recovery uneconomical, and the Company attempted to cement off the water section. However, this proved to be unsuccessful and the well is presently standing shut in. The well drilled to the west failed to encounter the same oil producing sands and was abandoned. The Company is undertaking further studies prior to re–drilling or re-entering this prospect.

In addition to the six wells drilled, five additional wells were re–entered in anticipation of increasing gas production to contract level. However, only two of the re–entries were placed on production, and only one is on production as of the date of this report. The 10–21–39–15 well re–entered in July of last year to evaluate the gas zone, indicated potential oil production and your Company successfully negotiated an oil lease with the Lessor. The well is currently producing intermittently.

The Halkirk plant and field facilities have an estimated market replacement value of $1,402,000.

While the results of the drilling and re–entry programs were not as gratifying as the Company originally hoped for, it should be noted that four of the wells drilled preserved leases for additional development at a future date, and the overall program did increase gas production. However, both markets and price have diminished greatly over the past eighteen months, and your Company has been unable to evaluate the true potential of the new producers, or proceed with tieing in additional wells for economic reasons.

Halkirk–Red Willow Drilling Program

Well Name Location	Spud	Rig Release	Total Depth	Status Remarks	Legacy % Interest
Legacy et al Halkirk E 14–34–39–14w4	09/07/86	09/12/86	1086 m	Potential Viking Gaswell Waiting on Pipeline	69%
Legacy et al Red Willow 10–28–39–15w4	08/23/86	08/29/86	1155 m	Potential Viking Gaswell Waiting on Pipeline	73%
Legacy et al Redwil 16–10–39–16w4	06/23/86	06/26/86	1020 m	Viking Gaswell On Production	73%
Legacy Home Redwil 10–11–39–16w4	01/17/87	01/24/87	1165 m	Abandoned	30%
Legacy et al Red Willow 14–24–39–16w4	09/03/87	09/09/87	1145 m	Abandoned	48%
Legacy et al Red Willow 16–24–39–16w4	07/15/86	07/21/86	1159 m	Basal Quartz Oilwell On Production 10/01/86 Shut–in 12/01/86	54%

Halkirk–Red Willow Re–Entry Program

Well Name	Re–Entered	Remarks Status	Legacy % Interest
Legacy AMOCO Red Willow 11–15–39–16w4	08/27/87	Perforate and Stressfrac Viking Shut In	100%
Legacy et al Red Willow 5–19–39–15w4	07/17/87	Perforate Viking, Flow test Viking and Basal Quartz On Production Sept/86–June/87 Shut In	50%
Legacy et al Halkirk 10–21–39–15w4	07/19/86	Test Colony & Basal Quartz Acquired oil lease from PanCanadian On Production July/87	100%
Legacy et al Red Willow 10–21–39–16w4	08/29/86	Perforate and Stressfrac Viking Shut In	100%
Legacy et al Red Willow formerly Merland et al Red Willow 7–24–39–16w4	09/02/86	Perforate and Sandfrac Viking On Production Sept/86	54%

BRITISH COLUMBIA

Granite Creek

During the year ended May 31, 1986, we announced a farmout on the Granite Creek gold and platinum mining prospect near Princeton British Colombia. While this agreement did not come together as anticipated, your Company did enter into an agreement to sell its interest in this prospect for $120,000 cash to a Calgary based firm — 313866 Alberta Ltd.

Under terms of the sales agreement, the numbered company paid an advance of $10,000 on January 23, 1987, with subsequent payments of $30,000 May 23, and $40,000 on September 23, 1987. The balance of $40,000 is due on January 23, 1988.

As previously expressed by your Company management, the prime direction is the area of exploration, development, and production of petroleum and natural gas substances. For this reason, it appeared in the Company's best interest to sell or farmout the Granite Creek prospect to provide additional funds for growth and development in the oil and gas sector. Funds from the sale of Granite Creek have been used to further the Company's activity during the past nine months.

SASKATCHEWAN

North Steelman

We are pleased to report that activity in the North Steelman area of southeastern Saskatchewan has picked up subsequent to year end. Your Company farmed out its 12.5% working interest in the Coho et al Lampman 15–36–5–6 (W2M) test to Transoil Corporation, whereby your Company is in an overriding position until payout. After payout your Company will have a 4.5% working interest in the test well. We are pleased to report that the well, which completed drilling in early September 1987, encountered commercial quantities of oil in the Huntoon Halbrite formation, and is expected to be placed on production prior to year end.

The new oil success has twenty feet (6 metres) of net pay with Legacy's share of estimated reserves calculated at 5,268 barrels.

As well, your Company has entered into a farmout agreement with Macedon Resources Ltd. for the drilling of a test well in 13–36–5–6 (W2M) later this year. Under terms of the farmout, your Company will be in a gross overriding royalty position until payout, at which time it will have the option to convert to a 6.25% working interest.

The preceding activity brings to five the total number of wells that your Company has an interest in, in the North Steelman area. Two additional wells operated by Macedon Resources Ltd. are on production, while a third well operated by Lasmo Exploration (Canada) Ltd. is currently suspended with the potential of being a water disposal well.

The potential for additional drilling in this area appears favorable for the coming fiscal year. Because of your Company's drilling plans in central Alberta, it has entered into farmouts in the Saskatchewan oil play with the election to convert to working interest after payout. In this way your Company can retain its exposure in the area, with a minimum cash outlay.

UNITED STATES

Activities in the United States have been relatively static during the past year, and the outlook does not appear to contain any new developments over the coming fiscal. Your Company is still looking for a suitor to acquire its U.S. subsidiary, with the primary attraction being the tax loss, and the remaining gross overriding royalty interests in Montana and Wyoming.

AUDITOR'S REPORT

To the Shareholders of
Legacy Petroleum Ltd.

I have examined the consolidated balance sheet of Legacy Petroleum Ltd. as at May 31, 1987 and the consolidated statements of loss, deficit and changes in financial position for the year then ended. My examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, these consolidated financial statements present fairly the financial position of the Company as at May 31, 1987 and the results of its operations and the changes in its financial position for the year ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

M. Jane McKinnon

October 2, 1987
Calgary, Alberta

M. Jane McKinnon
Chartered Accountant

CONSOLIDATED BALANCE SHEET

May 31, 1987

ASSETS

	1987	1986
Current Assets		
Cash	$ 60,707	$ 1,787
Accounts receivable	202,896	33,012
Oil and gas properties held for resale	–	3,524
Prepaid expenses	8,770	8,033
Current portion of notes receivable (Note 2)	2,125	2,125
	274,498	48,481
Notes Receivable (Note 2)	515,769	567,156
Capital Assets (Note 3)		
Mineral properties	–	591,607
Petroleum and natural gas properties	774,857	311,778
Plant and wellsite equipment	117,813	–
Automotive	3,650	4,100
Office equipment	25,055	19,630
	921,375	927,115
Less: Accumulated depreciation and depletion	101,917	37,420
	819,458	889,695
Approved by the Board:	$1,609,725	$1,505,332

Director *[signature]*

Director *[signature]*

LIABILITIES

	1987	1986
Current Liabilities		
Bank indebtedness	$	$ 20,311
Accounts payable and accrued liabilities	194,962	99,024
Salary payable	4,637	16,638
Current portion of promissory note payable to officer and director (Note 5)	–	33,000
Due to shareholders (Note 4)	51,407	40,041
Current portion of long–term debt (Note 6)	90,307	97,469
	341,313	306,483
Advance from Landlord on Long–term Lease	9,375	12,375
Bonus payable to Officer and Director Due December 31, 1995	391,000	391,000
Promissory Notes Payable to Officer nd Director (Note 5)	210,784	177,784
Long–term Debt (Note 6)	147,103	–
Contingency (Note 11)		

SHAREHOLDER'S EQUITY

		1987	1986
Capital Stock (Note 7)			
Authorized –	Unlimited Class A voting common shares		
	Unlimited Class B non–voting common shares		
	500,000 Preferred shares		
Issued –	17 Preferred shares (1986 – 25)	170,000	250,000
	3,422,978 Class A shares (1986 –2, 182,898)	3,423,089	2,915,023
		3,593,089	3,165,023
		(3,082,939)	(2,547,333)
		510,150	617,690
		$ 1,609,725	$ 1,505,332

CONSOLIDATED STATEMENT OF LOSS

Year Ended May 31, 1987

	1987	1986
Revenue		
Oil sales	$ 24,827	$ 9,986
Gas sales	227,316	141,884
Other	46,798	24,665
	298,941	176,535
Less: Royalties	20,141	19,949
	278,800	156,586
Expenses		
Operating	122,964	45,754
Interest on long–term debt	18,574	16,711
General and administrative	111,188	163,926
Commissions (recovered)	–	(21,573)
Depreciation and depletion	66,607	31,331
	319,333	236,149
Loss from Operations	(40,533)	(79,563)
Oil and gas properties surrendered	3,466	65,084
Loss before income taxes and extraordinary items	(43,999)	(144,647)
Income taxes	–	1,428
Loss before extraordinary items	(43,399)	(146,075)
Extraordinary items		
Excess of cost of mining lease over disposal	(471,607)	–
Recovery of income taxes due to application of prior year losses	–	6,960
	(471,607)	6,960
Net Loss for the Year	$(515,606)	$(139,115)
Basic earnings (Loss) per common share (Note 7)		
Before extraordinary items	$ (0.02)	$ (0.08)
Extraordinary items	(0.18)	0.01
Including extraordinary items	$ (0.20)	$ (0.07)

CONSOLIDATED STATEMENT OF DEFICIT

Year Ended May 31, 1987

	1987	1986
Deficit, Beginning of year	$ (2,547,333)	$ (2,398,218)
Net Loss for the year	(515,606)	(139,115)
	(3,062,939)	(2,537,333)
Dividends on Preferred shares	(20,000)	(10,000)
Deficit, End of year	$ (3,082,939)	$ (2,547,333)

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

Year Ended May 31, 1987

	1987	1986
Operations		
Net Loss	$ (515,606)	$ (139,115)
Add		
Depreciation and depletion	66,607	31,331
Capital assets surrendered		
- Petroleum and natural gas properties	3,466	35,327
Excess of cost of mining lease over disposal	471,607	–
Non cash payment of salary	–	48,327
Loss (Gain) on sale of capital assets	864	(1,482)
	26,938	(25,612)
Financing		
Preferred shares issued for petroleum and natural gas properties	–	250,000
Common shares issued for petroleum and natural gas properties	191,498	–
Common shares issued in settlement of debt	214,037	–
Common shares issued	102,700	–
Lease rental inducement	–	12,375
Proceeds on sale of mining lease	120,000	–
Proceeds on sale of capital assets	521,800	2,750
Proceeds on note receivable	51,387	2,125
Proceeds on long term debt	182,366	16,786
	1,410,726	258,424
Redemption of Preferred shares	(80,000)	–
Repayment of long term debt	(41,843)	(44,386)
Dividend on preferred shares	(20,000)	(10,000)
	1,268,883	204,038
Change in working capital other than cash	(99,267)	73,153
	1,169,616	277,191
Investing		
Additions to capital assets		
Petroleum and natural gas properties	(969,079)	(263,573)
Production equipment	(117,813)	–
Automotive and other equipment	(23,804)	(13,184)
	(1,110,696)	(276,757)
Increase in Cash	58,920	434
Cash, beginning of year	1,787	1,353
Cash, end of year	$ 60,707	$ 1,787

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Year Ended May 31, 1987

1. SUMMARY OF ACCOUNTING POLICIES

The following accounting principles and practices are set forth to facilitate the understanding of data presented in the financial statements:

a) *Principles of Consolidation*

The activities of the Company and its wholly–owned subsidiaries, Harkor Developments Ltd., and Legacy Oil and Gas Ltd. and its wholly–owned United States subsidiaries, Legacy Oil and Gas Inc. and Benchlands Oil and Gas Inc. are included in these financial statements.

The acquisitions of subsidiary companies have been accounted for by the purchase method, and accordingly, earnings or losses since the dates of acquisition are included in the consolidated statement of loss and deficit.

The excess of consideration paid for the shares of the subsidiary companies over the book value of their net assets at dates of acquisition has been included in mineral properties and oil and gas properties held for resale in the consolidated financial statements and has been amortized or written off on the same basis as such assets.

b) *Capital Assets*

i) *Mineral Properties*

Acquisition and deferred exploration and development costs are capitalized on an area of interest basis. These expenditures will be charged against income when properties are developed to the stage of commercial production through unit of production depletion. Accumulated costs related to an area of interest are charged to earnings if the property is sold or abandoned.

ii) *Petroleum and Natural Gas Properties*

The Company follows the full cost method of accounting for oil and gas operations whereby all costs related to exploration for and development of oil and gas reserves are capitalized. Costs capitalized include those related to acquisition of petroleum and natural gas rights, geological and geophysical expenses, carrying costs on non–producing property, drilling of wells and applicable overhead expenses. These capitalized costs are accumulated in separate geographically located cost centers for each country in which the Company operates, at present Canada and the United States. All such costs are depleted on the unit of production method based on estimated proven reserves of oil and gas.

The Company carries its oil and gas properties at the lower of costs and the estimated present value of future net revenues from production of the underlying reserves.

Substantially all of the Company's exploration, development and production activities related to oil and gas are conducted jointly with others; accordingly, the accounts reflect only the Company's proportionate interest in such activities.

iii) *Other*

Automotive and other equipment are depreciated using the declining balance method at the following rates per annum:

Automotive	30%
Office equipment	20%
Plant and wellsite equipment	20%

*c) **Foreign Currency Translation***

The foreign subsidiaries accounts have been translated into Canadian dollars at the rate in effect at the balance sheet date for monetary assets and liabilities. Non–monetary assets and liabilities are translated at applicable historical rates. Revenue and expense items are translated at the average rate of exchange for the year.

*d) **Advance from Landlord on Long Term Lease.***

This advance is being applied against monthly rent of office premises, over the term of the lease.

2. NOTES RECEIVABLE

	1987	1986
Notes receivable due December 31, 1995	$391,000	$391,000
Notes receivable due October 1990, repayable in annual installments of $1,525 to May 31, 1990 with the balance of $94,751 due; $68,181 July 1, 1990 and $26,570 October, 1990.	99,326	149,481
Notes receivable due December 1995, repayable in annual installments of $600 to May 31, 1994 with the balance of $23,368 due; $11,668 June, 1994 and $11,700 December, 1995	27,568	28,800
	517,894	569,281
Current Portion	2,125	2,125
	$515,769	$567,156

The notes receivable are non–interest bearing and are due from present and former officers and directors of the Company.

3. CAPITAL ASSETS

	1987 Cost	1987 Accumulated Depletion and Depreciation	1987 Net Book Value	1986 Net Book Value
Canadian petroleum and natural gas properties	$774,857	$ 67,508	$ 707,349	$ 283,020
Canadian mineral properties	–	–	–	591,607
Automotive	3,650	414	3,236	3,695
Office equipment	25,055	10,433	14,622	11,373
Plant and wellsite equipment	117,813	23,562	94,251	–
	$ 921,375	$ 101,917	$ 819,458	$ 889,695

4. DUE TO SHAREHOLDERS

The amounts due to shareholders are unsecured, are either non–interest bearing or bear interest at rates ranging from 15% to 17.75% and are due on demand.

5. PROMISSORY NOTES PAYABLE TO OFFICER AND DIRECTOR

	1987	1986
Promissory note, payable to A. K. Mossfeldt, due April 1, 1995.	$ 39,250	$ 39,250

	1987	1986
Promissory note, payable to A.K. Mossfeldt, due April 1, 1995.	171,534	171,534
	210,784	210,784
Current Portion	–	33,000
	$210,784	$177,784

During the year, the terms of the notes payable to officer and director were amended, extending the maturity dates to April 1, 1995.

6. LONG–TERM DEBT

	1987	1986
U. S. Bank loan at 14.5% repayable in monthly installments of U. S. $2,000 principal and interest with the balance due December 25, 1986.	$ –	$11,395
U. S. Bank loan (U. S. $56,378) bearing interest at 12.75% per annum due May 27, 1988, secured by assets of the President of the Company	75,547	86,074
Bank loan bearing interest at prime plus 2 1/2 %, repayable in monthly installments of $500 principal and interest due July, 1989	11, 863	–
Bank loan bearing interest at 9% per annum repayable in monthly installments of $1,900 principal and interest, due January 1997. The following security has been pledged: a) General assignment of book debts. b) Continuing debenture for $250,000 at prime + 2%, fixed on certain gas properties. c) Specific assignment of TransCanada Pipe Lines gas contract.	150,000	–
	237,410	97,469
Less current portion	90,307	97,469
	$ 147,103	$ 0

Repayment of long term debt over the next five fiscal years will be as follows:

1988	$ 90,307
1989	16,296
1990	13,464
1991	12,948
1992	14,139
Subsequent	90,256
	$ 237,410

7. CAPITAL STOCK

Issued:

a) Class A voting Shares

	1987 Number of Shares	1987 Stated Value	1986 Number of Shares	1986 Stated Value
Balance, beginning of year	$ 2,182,898	$ 2,915,023	$ 2,182,898	$ 2,915,023
Issue of shares in settlement of accounts payable	638,799	214,037	–	–

	1987 Number of Shares	1987 Stated Value	1986 Number of Shares	1986 Stated Value
Issue of shares for stock options exercised	70,000	7,700	–	–
Issue of shares by private placement	250,000	95,000	–	–
Issue of shares to acquire petroleum and natural gas properties	281,281	191,498	–	–
	$ 3,422,978	$ 3,423,258	$ 2,182,898	$ 2,915,023

At May 31, 1987, 144,218 shares at a stated value of $126,082 were earned but not formally issued. The shares were issued in July 1987 but are included in the year ended.

b) First Preferred Shares

	1987 Number of Shares	1987 Stated Value	1986 Number of Shares	1986 Stated Value
Balance, beginning of year	25	$ 250,000	–	$ –
Issued	–	–	25	$250,000
Redeemed	(8)	(80,000)	–	–
	17	$ 170,000	25	$ 250,000

The shares have been designated as follows:

i) 8% cumulative, redeemable retractable convertible

ii) the shares are retractable as follows:
8 shares on November 1, 1987
9 shares on November 1, 1988

iii) in the event of default, provisions exist to convert the shares to common trading shares.

c) Stock Options

The company has entered into an option agreement with certain directors and employees whereby 550,000 Class A common shares were reserved for issue at an exercise price of $0.11 per share. The agreement expires April 30, 1996.

8. RENUMERATION OF DIRECTORS AND SENIOR OFFICERS

Renumeration provided in the books to directors and senior officers was $37,830 of which $19,830 remains unpaid.

9. INCOME TAXES

The Company has accumulated losses for Canadian income tax purposes of $437,568 and $647,410 (U. S.) for United States income tax purposes, the related benefit of which has not been recognized in th financial statements. Unless sufficient taxable income is earned by the Company, the losses for Canadian income tax purposes expire as follows:

1990	$ 43,909
1991	381,139
1992	10,401
1994	2,119

The losses for United States income tax purposes will expire in 2001.

10. SUBSEQUENT EVENTS

On August 1, 1987, $43,000 of Preferred Shares, Series #1 were redeemed by the Company.

11. CONTINGENCY

A statement of claim in the amount of $127,130 has been filed against the Company. A counterclaim has been filed in the amount of $336,440. It is the opinion of the Company's legal counsel that this action will not result in any adverse material effect in the financial affairs of the Company, therefore no potential liability has been recorded in these financial statements.

12. SEGMENTED INFORMATION

The Company's operations are conducted in Canada and the United States through three industry segments – the sale of oil and gas leases, mineral exploration and oil and gas production. During the current year the Company operated only in oil and gas production. Substantially all of the Company's activities during the year were in Canada.

CORPORATE HISTORY

Legacy Petroleum Ltd. was incorporated October 14, 1970 as Francis Creek Mines Ltd. (NPL) a private Company. On June 14, 1971, Francis Creek Mines Ltd. (NPL) changed its name to Frances Creek Mines Ltd. (NPL), a private Company. On December 21, 1971, Frances Creek Mines Ltd. (NPL) became a publicly listed Company on the Alberta Stock Exchange. In September 1975, the Company changed its name to Cal–West Petroleums Ltd. (NPL). In April 1976 the Company acquired all the issued and outstanding shares of Harkor Developments Ltd. whose primary asset was a gold mining claim at Granite Creek, British Columbia.

In February 1983 Cal–West was continued under the Alberta Business Corporations Act. In March of that year, control of the Corporation was obtained by a group of businessmen headed by A. Kenneth Mossfeldt, President of Legacy Oil & Gas Ltd. In September 1983 shareholders of both Cal–West and Legacy approved a share exchange whereby Cal–West acquired the 3,300,009 issued and outstanding shares of Legacy for a like number of shares of Cal–West.

In May of 1986 Shareholders ratified a change of name from Cal–West Petroleums Ltd. (NPL) to Legacy Petroleum Ltd.; approved a consolidation of share capital based on five (5) of the old Cal–West shares for each (1) of the new Legacy Shares; and approved the creation of a Class "B" non voting common share, and the creation of Preferred shares. No Class "B" shares have been issued to date.

The Cal–West designation for the Corporation was delisted from the Alberta Stock Exchange and "Legacy Petroleum Ltd." was called for trading on June 26, 1985. The initial trade was made on August 21, 1985 at 35 cents per share.

On November 1, 1986, the Corporation issued to Merland Explorations Limited now North Canadian Oils Limited, twenty–five (25) 8% Redeemable Retractable Convertible First Preferred Shares with a value of $10,000 per share, to acquire a 50% working interest in a gas plant and from 48.75% to 65% working interest in petroleum and natural gas producing and non–producing leases associated with the gas plant at Halkirk, Alberta. These lands are highlighted on the map elsewhere in this report. Subsequent to the acquisition from North Canadian the Corporation increased its interest to 100% in the gas plant.

With its initial step as a producer/operator taken the Corporation embarked on an aggressive program of exploration and development of these leases, as highlighted elsewhere in this report.

In September 1986 the Corporation, in an effort to increase its asset based, acquired a 47.8% interest in a second gas plant and producing and non–producing properties at Castor, Alberta, some ten miles from its Halkirk holdings. The acquisition, at a cost of $135,000 was paid for by 225,000 Class "A" common trading share from Treasury.

As well during the current year, the Corporation redeemed 8 of its Series #1 Preferred shares, and subsequent to year end redeemed an additional $43,000 worth of shares. The balance of $37,000 will be redeemed November 1, 1987 in keeping with its August 1985 agreement with North Canadian Oils Limited.

The Corporation was also successful in selling its interest in the Granite Creek gold mine for a cash consideration of $120,000. The purchase price is payable over the period of a year, and has provided the Corporation with additional monies for growth and development.

Legacy

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